

1 KRISTIN T. MIHELIC, ATTORNEY #278483
2 TRIAL ATTORNEY
3 OFFICE OF THE UNITED STATES TRUSTEE
4 880 FRONT STREET, SUITE 3230
5 SAN DIEGO, CA 92101-8511
(619) 557-5013

6 Attorney for
7 TIFFANY L. CARROLL
8 ACTING UNITED STATES TRUSTEE

9
10
11
12
13
14
15
16
17
18
19
20
21
UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF CALIFORNIA

In re: } Case No. 18-06051-LT11
} UNITED STATES TRUSTEE'S
} MOTION TO CONVERT CASE TO
} ONE UNDER CHAPTER 7, OR IN
} THE ALTERNATIVE, FOR
} APPOINTMENT OF CHAPTER 11
} TRUSTEE
} Hearing Date:
} Hearing Time:
} Judge: Laura S. Taylor
CHRISTOPHER D. DOUGHERTY }
and NEREIDA I. DOUGHERTY, }
Debtors in Possession }

NOW COMES, the United States Trustee ("UST"), by and through her attorneys, and for her Motion To Convert Case To One Under Chapter 7, Or In the Alternative, For Appointment of Chapter 11 Trustee, states as follows:

Following the testimony of the Debtors at three sessions of the 341 Meeting of Creditors, and the review of hundreds of documents regarding the Debtors' financial affairs and business operations, it is apparent that the case must be converted due to the Debtors' unexcused failures to satisfy timely the filing and

1 reporting requirements and to timely provide information reasonably requested by
2 the UST; the Debtors' gross mismanagement of the Estate post-petition; and the
3 continuing and substantial losses to the Estate and the absence of a reasonable
4 likelihood of rehabilitation.

5 The UST has formed the preliminary view that the Debtors do not engage in
6 business operations that would justify the appointment of a Chapter 11 Trustee.
7 However, the Debtors have not been forthcoming in their testimony at the 341
8 Meeting of Creditors and new facts regarding the scope and nature of their
9 business interests frequently come to light. In addition, the Debtors are members
10 and shareholders of at least three closely-held companies, some of which appear to
11 have active and substantial business operations. As a result, the UST requests the
12 alternative relief of the appointment of a Chapter 11 Trustee, pursuant to Section
13 1104 of the Bankruptcy Code, for cause based upon fraud committed by the
14 Debtors prior to the commencement of the case and gross mismanagement of the
15 Debtors after commencement of the case.

16 //

17 //

18 //

19 //

20

21

FACTUAL BACKGROUND

Post-Petition Compliance Deficiencies And Business And Financial Mismanagement

The Debtors filed their voluntary petition under Chapter 11 on October 9, 2018.¹ All of the Debtors' monthly operating reports were filed late as follows:

Court Doc Number	Period	Date Filed
98	October 2018	January 16, 2019
99	November 2018	January 16, 2019
122	December 2018	February 5, 2019
153	January 2019	February 27, 2019

See Declaration of Kenneth Dennis dated March 13, 2019 at ¶ 3.

The Debtors are the majority or sole owners and members of the following entities:

Entity	Percentage Owned
C&D Professional Services, Inc.	100%
JTA Farm Enterprises, LLC	85%
JTA Real Estate Holdings, LLC	100%
RD3, Inc.	100%

See Dennis Decl. at 12.

During the course of the three sessions of the 341 meeting of creditors, and thereafter, the UST requested that the Debtors provide numerous documents

¹ The UST requests that the Court take judicial notice of the docket and the filings in this case pursuant to F.R.E. 201.

1 concerning their business and financial affairs, as well as explanations for
2 transactions appearing in the monthly operating reports. See Dennis Decl. at ¶ 1.
3 The Debtors have failed to provide numerous items requested by the UST
4 including providing evidence of the opening of DIP bank accounts and the closing
5 of their prepetition accounts. See Exh. 1 to Dennis Decl. Upon information and
6 belief, the Debtors have failed to open any debtor-in-possession bank accounts and
7 have failed to close their pre-petition accounts.

8 Among the currently outstanding documents requested by the UST are the
9 following key items: bank statements for 22 additional bank accounts, the
10 existence of which was independently discovered by the UST and not disclosed by
11 the Debtors; questions regarding a bar and an investment represented by the
12 Debtors to being held for the benefit of the Debtors' children while income is
13 being received by the Debtors; records concerning numerous cash withdrawals in
14 amounts over \$500; bank statements for accounts held in the names of the Debtors'
15 children; a detailed list of all real and personal property (value over \$200) in the
16 possession or control of the Debtors or any of their affiliated entities as of the
17 petition date; copies of paypal and Venmo statements; and 38 questions on activity
18 reported in the monthly operating reports. See Dennis Decl. at ¶ 1.

19 The Debtors provided a list of responses to the 38 questions concerning the
20 monthly operating reports on March 8, 2019. See Dennis Decl. at ¶ 2; Exh. 12 to
21

1 Dennis Decl. However, in almost every instance, the explanation was inadequate to
2 justify the disbursement from Estate funds. The Debtors paid the expenses of adult
3 family members, expenses for other entities, or failed to provide the requested
4 documentation for over \$35,000 in disbursements for the time period October 9,
5 2018 through December 31, 2018. A detailed list of the unjustified disbursements
6 is set forth in paragraph 2 of the Dennis Declaration.

7 The operating reports show that the Debtors have continued to spend
8 amounts on themselves that appear to be excessive or unusual. They also show
9 that the Debtors paid expenses post-petition totaling \$15,099.76 for other entities.

10 See Exh. 12 to Dennis Decl. A chart outlining the expenses paid by the Debtors
11 post-petition for their related entities is set forth in paragraph 4 of the Dennis
12 Declaration.

13 The operating reports filed in this case report the following income and
14 expense activity:

	Oct 9 to Oct 31, 2018	November 2018	December 2018	January 2019
Receipts	16,275.40	31,082.38	17,883.55	18,939.01
Disbursements	11,966.96	29,764.27	25,677.95	9,570.65

18 See Dennis Decl. at ¶ 5.

1 The operating reports do not generally reveal income from business
2 activities. Rather, the operating reports reveal transfers and deposits from
3 unknown sources. See Dennis Decl. at ¶ 6.

4 On November 19, 2018, the Court entered an Order allowing Ms. Dougherty
5 to use her \$6,527.33 net monthly salary from San Diego Mesa College for living
6 expenses. See Dennis Decl. at ¶ 7. On February 7, 2019, the Court entered an
7 Order (Docket No. 126) allowing the Debtors to use \$3,500 per month owner
8 withdrawal from JTA Real Estate Holdings, LLC (“JTA Real Estate”) and \$3,000
9 per month owner withdrawal from JTA Farm Enterprises, LLC (“JTA Farms”) for
10 living expenses. See Dennis Decl. at ¶ 8. The total amounts that the Court
11 authorized the Debtors to use was \$13,027.33. See Dennis Decl. at ¶ 9.

12 The amount of disbursements reported in the November 2018 and December
13 2018 operating reports exceed the authorized amounts by \$16,736.94 for
14 November 2018 and \$12,650.62 for December 2018 as follows:

	November 2018	December 2018
Disbursements	29,764.27	25,677.95
Amount Authorized by the Court	13,027.33	13,027.33
Excess Amount	16,736.94	12,650.62

19 See Dennis Decl. at ¶ 9.
20
21

1 The operating reports reflect that the Debtors also appear to be regularly
2 transferring Estate funds to and from family member accounts without Court
3 approval and for unknown reasons. See Dennis Decl. at ¶ 10. The UST has
4 requested, but has not received, copies of bank statements for the Debtors' minor
5 children. A detailed list of the transfers reported in the operating reports is set
6 forth in paragraph 10 of the Dennis Declaration. These transfers include numerous
7 deposits into the Debtors' account from accounts apparently belonging to the
8 minor children, which have not been disclosed by the Debtors, as well as
9 disbursements made to the minor children. Id.

10 The operating reports do not include copies of the disbursement checks.
11 Dennis Decl. at ¶ 11. The operating reports reflect regular bank deposits but
12 provide little information regarding the source or purpose of the funds. Id. The lack
13 of disclosure makes it difficult for creditors and the UST to monitor and
14 understand the Debtors' financial activities and to evaluate whether the Debtors are
15 acting in the best interest of the Estate. Id.

16 At the Section 341 meeting held on January 15, 2019, Mr. Dougherty
17 testified that JTA Real Estate would be filing Chapter 11 and would file a joint
18 plan of reorganization with the Debtors. Dennis Decl. at ¶ 13. He testified that the
19 Plan would be funded by the sale of the ranch located at 21702 Japatul Rd. in
20 Alpine, California and through income produced from the use of the trucks owned
21

1 by JTA Real Estate. Id. The trucks owned by JTA Real Estate are operated by
2 RD3, Inc. Dennis Decl. at ¶ 14.

3 The Debtors have filed four Rule 2015.3 periodic reports for RD3, Inc.,
4 which collectively cover the time period January 2016 through January 2019. Id.
5 The profit and loss statements included with the reports are summarized as
6 follows:

	2017	11 months ended 11/30/18	December 2018	January 2019
Total income	612,702.45	328,053.99	0.00	0.00
Total expenses	605,086.36	324,091.80	1,236.23	0.00
Net gain/loss	7,616.09	3,962.17	<1,236.23>	0.00

11 See Dennis Decl. at ¶ 14.
12

13 These reports reflect net gains and losses that demonstrate that RD3, Inc.'s
14 operations do not have the ability to fund a plan. Dennis Decl. at ¶ 16.
15 Furthermore, a review of the associated general ledgers shows that 71.2% of the
16 income reported income for 2017 and 86.6% of the income reported for 2018 was
17 for work performed for entities controlled by the Debtors. Dennis Decl. at ¶ 15. A
18 summary of the reported income of RD3, Inc. is set forth in paragraph 15 of the
19 Dennis Declaration.
20
21

1 The Rule 2015.3 reports show that RD3, Inc. does not have revenues from
2 third party customers that could fund a chapter 11 plan. Dennis Decl. at ¶ 16.
3 There is no basis to conclude that the Debtors have experience operating a
4 business, using the trucks owned by JTA Real Estate, with revenues sufficient to
5 fund a chapter 11 plan. Id.

6 In addition, the Rule 2015.3 reports filed by the Debtors for JTA Real Estate
7 and JTA Farms also demonstrate the Debtors' inability to profitably operate a
8 business. Dennis Decl. at ¶ 17. The Rule 2015.3 reports filed for JTA Real Estate
9 reflect losses for all periods except for January 2018 - November 2018 which
10 purports to report a gain of \$96,963.35. Dennis Decl. at ¶ 17. A chart summarizing
11 the income and expenses for JTA Real Estate is set forth in paragraph 17 of the
12 Dennis Declaration.

13 Included in the January to November 2018 profit and loss statement is a
14 negative expense of \$574,794.15 described as "Reconciliation Discrepancies."
15 When the UST adjusted the profit and loss statement for this negative expense, the
16 adjustment resulted in a loss of <\$477,830.80> as follows:
17
18
19
20
21

	Doc 72 January to November 2018
Income	221,450.02
Expenses	124,486.67
Reported net income <Loss>	96,963.35
Less Reconciliation Discrepancies	574,794.15
Adjusted Net income <Loss>	(477,830.80)

Dennis Decl. at ¶ 18.

The Rule 2015.3 reports filed by the Debtors for JTA Farms include questionable accounting. When the UST made appropriate adjustments, the adjustments resulted in a net loss in 2017 of <\$194,387.64.>. Dennis Decl. at ¶ 19 – 20. A detailed description of the adjustments made to the 2017 profit and loss statement for JTA Farms is set forth in paragraphs 19 and 20 of the Dennis Declaration.

The profit and loss statement included with the Rule 2015.3 report for January to December 2018 reflects a loss of <\$78,498.16>. Dennis Decl. at ¶ 21. This report also contains unusual accounting. Dennis Decl. at ¶ 22. The general ledger included with the report reveals that \$105,000 in income consisted of “equity deposits” received from the “Dougherty Family Trust Fund”. Id. These deposits consisted of six \$15,000 monthly receipts received between February 1,

1 2018 and July 1, 2018. Id. The general ledger also reports \$155,097.77 in
2 “Reconciliation Discrepancies” that are not explained in the report. Id.

3 When the UST adjusted the 2018 profit and loss statement for “equity
4 deposits” and “reconciliation discrepancies”, the adjusted net loss for this period
5 was <\$28,379>. Dennis Decl. at ¶ 23. Detailed charts outlining the UST’s
6 calculations for JTA Farms’ profit and loss are set forth in paragraphs 21 through
7 23 of the Dennis Declaration.

8 The profit and loss statement included with the 2015.3 report for January
9 2019 for JTA Farms also includes a \$15,000 equity deposit apparently received in
10 January 2019 and classified as income. Dennis Decl. at ¶ 24. The general ledger
11 included with the report did not include an account for equity contributions.
12 Therefore, the UST was unable to determine if the source of the \$15,000 was also
13 the Dougherty Family Trust Fund. Dennis Decl. at ¶ 25. The Debtors’ January
14 2019 Operating Report does not include any disclosure about this \$15,000, and
15 does not reference the Dougherty Family Trust Fund. Id.

16 The operating reports and the motions for relief from the automatic stay filed
17 in this case report that the Debtors are delinquent on the pre and post-petition
18 mortgage obligations. Dennis Decl. at ¶ 26. The January 2019 Operating Report
19 reports post-petition delinquencies to HSBC and Lyon/Chestnut. Id.

The Court docket for this case reveals that 12 adversary complaints predicated on section 523 to determine dischargeability of debt have been filed against the Debtors. A detailed summary of these adversary proceedings is set forth in paragraph 28 of the Dennis Declaration.

The entities owned by the Debtors have demonstrated pre-petition and post-petition that they do not have the ability to generate net income that can be used to fund a plan. See Dennis Decl. at ¶ 29. RD3, Inc. is not operating and neither JTA Farms nor JTA Real Estate is able to produce net income. Id. The Debtors and their entities have been unable to timely pay their monthly post-petition mortgage payments and appear to have no ability to fund the defense of the 12 adversary proceedings. Indeed, it was reported by Debtors' counsel on the record during the hearing on February 28, 2019 that the Debtors had instructed him not to oppose any adversary proceeding and to stipulate to the full amount being requested in each adversary complaint. The liability of the Estate attributable to these adversary proceedings is currently unknown.

Pre-Petition Fraud and Ponzi Scheme

The following bank statements were provided to the UST by the Debtors for C&D Professional Services Inc. (“C&D”) for 2018:

Bank	Account Number	Periods covered
US Bank	1002	November 24, 2017 to March 31, 2018

1	Bank of America	3774	January 1, 2018 to November 30, 2018
2	San Diego County Credit Union	8337	March 9, 2018 to August 31, 2018

3 Dennis Decl. at ¶ 30.

4 The UST was able to independently obtain copies of many of the counter
5 withdrawals, deposit information, and check copies not included with the provided
6 bank statements (“Additional Banking Documents”). Dennis Decl. at ¶ 31. A
7 review of the bank statements provided by the Debtor and the Additional Banking
8 Documents reveals that C&D received eight amounts totaling \$1,159,378.46 from
9 investors between December 8, 2017 and May 2, 2018. Id. A detailed list of these
10 investments is set forth in paragraph 31 of the Dennis Declaration.

11 The UST was unable to find evidence from the review of the bank
12 statements that that these funds were directly invested or used for the benefit of
13 these investors. Dennis Decl. at ¶ 32. Instead the funds were deposited into bank
14 accounts belonging to C&D then immediately thereafter, the deposits were either:
15 (1) disbursed to other investors (and sometimes the same investor) and noted on
16 the check as “dividends” or “principal”; (2) transferred to the Dougherty Family
17 Trust; (3) used for C&D operating expenses (or possibly operating expenses of
18 other affiliated entities); or (4) used to pay the personal expenses of Chris

1 Dougherty, with a large portion of these funds having been withdrawn by Chris
2 Dougherty at bank branches.

3 The Debtors filed four Rule 2015.3 periodic reports for C&D with the Court
4 covering the time period January 2016 through January 2019. See Dennis Decl. at
5 ¶ 33.

6 The reports included general ledgers for the periods covered by the reports.
7 See Dennis Decl. at ¶ 34. The UST reviewed the general ledgers to gain an
8 understanding of how C&D was accounting for investor funds deposited into its
9 accounts. The UST was unable to find five investor deposits, or any accounting
10 for them, in the general ledgers. Id. A detailed list of the investor deposits that are
11 missing from the C&D general ledgers is set forth in paragraph 34 of the Dennis
12 Declaration.

13 The UST also notes that the general ledger included with the November 30,
14 2018 report did not clearly identify an additional three of the investor deposits. It
15 appears to the UST that the amounts were recorded as C&D revenue and income
16 instead of as a trust liability for investor funds. See Dennis Decl. at 35-36.

17 The UST has preliminary determined how the Debtors expended the
18 \$1,159,378.46 of investor funds, which is detailed as follows.

19 The balance in US Bank account ending in 1002 was \$3,599.73 when
20 \$300,000 was received from the Spruill Family Trust on December 8, 2017. See
21

1 Dennis Decl. at ¶ 38. By December 19, when most of the funds had been spent, the
2 balance of the account had been reduced to \$32,109.87. See Id.; Exh. 2, 3 to
3 Dennis Decl.

4 From the bank documents, the UST prepared an accounting of how the
5 \$300,000 was spent. Id. Legible notations from copies of the investor canceled
6 checks in Exhibit 3 are designated with quotation marks:

Date	Ck#	Paid to/Received from	Deposits	With/withdrawals	Balance	Description
		Beginning bank balance			3,600	
12/8/17		Wire credit	300,000		303,600	Spruill Family Trust
12/8/17		Customer Withdrawal		30,000	273,600	W/D Chris Dougherty
12/8/17		Customer Withdrawal		16,000	257,600	W/D Chris Dougherty
12/8/17		Customer Withdrawal		7	257,593	W/D Chris Dougherty
12/8/17		Customer Withdrawal		28,000	229,593	W/D Chris Dougherty
12/8/17	119	Chase Marriott Rewards		8,500	221,093	Credit Card Payment
12/8/17		Customer Withdrawal		60	221,033	W/D Chris Dougherty
12/8/17		Customer Withdrawal		40,007	181,026	W/D Chris Dougherty
12/8/17		Customer Withdrawal		16,000	165,026	W/D Chris Dougherty
12/11/17	116	Alan Silver		6,431	158,595	"Div"
12/11/17	115	James Lara		1,212	157,383	Payment to investor
12/11/17		Customer Withdrawal		15,000	142,383	W/D Chris Dougherty
12/11/17	118	Navy Federal CC		8,500	133,883	Credit card payment
12/11/17		Egnyte Inc		45	133,838	Office expense
12/11/17		Shell Service Station		75	133,763	Auto expense
12/12/17		Customer Withdrawal		20,000	113,763	W/D Chris Dougherty
12/12/17		Customer Withdrawal		20,000	93,763	W/D Chris Dougherty
12/12/17		Customer Withdrawal		10,000	83,763	W/D Chris Dougherty
12/12/17		Temecula Creek I		54	83,709	Personal travel
12/12/17		Springhill Suite		371	83,338	Personal travel
12/13/17		Fusion Investment	3,288		86,626	
12/13/17	117	Bryan Dougherty		10,425	76,201	Payment to family member
12/13/17		DLX FOR SMALLBUS		155	76,046	Office expense

1	12/14/17	121317	Navy Federal CU		4,501	71,545	Credit card payment
2	12/14/17		Safeco Insurance		1,011	70,534	Insurance
3	12/15/17	106	Sharon Vega		127	70,407	"3 rd Quarter"
4	12/15/17	120	Hank Austin		1,738	68,669	Payment to investor
5	12/15/17		Customer Withdrawal		2,000	66,669	W/D Chris Dougherty
6	12/18/17		Kenneth Miller	90		66,759	Other
7	12/18/17		Compupay Inc	17		66,776	Other
8	12/18/17	118	Elena Totten		1,650	65,126	Payment to investor
9	12/18/17	123	Melba Summers		5,000	60,126	"Prin Dist"
10	12/18/17	1000	Chase Card Services		1,900	58,226	Credit card payment
11	12/18/17		Customer Withdrawal		10,000	48,226	W/D Chris Dougherty
12	12/18/17		D Lish Express		21	48,205	Meals
13	12/18/17		Katsu Seafood		75	48,130	Meals
14	12/18/17		CAT Commercial A		4,637	43,492	Equipment payment
15	12/19/17	121	Sixta Loyo		200	43,292	"3 rd qrt Div"
16	12/19/17		Customer Withdrawal		2,000	41,292	W/D Chris Dougherty
17	12/19/17		Customer Withdrawal		9,000	32,292	W/D Chris Dougherty
18	12/19/17		Customer Withdrawal		7	32,285	W/D Chris Dougherty
19	12/19/17		Romanos 1283		79	32,206	Meals
20	12/19/17		Destination XL		97	32,110	Personal clothing

12 Dennis Decl. at ¶ 38.

13 The balance in US Bank account ending in 1002 was \$32,109.87 when
14 \$200,000.00 was received from the Spruill Family Trust on December 19, 2017.

15 See Dennis Decl. at ¶ 39. By December 22 when the funds had been spent, the
16 balance in the account had been reduced to \$25,485.45. Id.; Exh. 2, 3 to Dennis
17 Decl.

From the bank documents, the UST prepared an accounting of how the \$200,000 was spent. Id. Legible notations from copies of the investor canceled checks in Exhibit 3 are designated with quotation marks:

Date	Ck #	Paid to/Received from	Deposit	With/withdrawals	Bank Balance	Description
12/19/17		Beginning bank balance			32,110	
12/20/17		Wire credit	200,000		232,110	Spruill Family Trust
12/20/17		Customer Withdrawal		10,007	222,103	W/D Chris Dougherty
12/20/17		Customer Withdrawal		30,000	192,103	W/D Chris Dougherty
12/20/17		Return item credit	7		192,110	Returned item credit
12/20/17		Customer Withdrawal		5,000	187,110	W/D Chris Dougherty
12/20/17		Customer Withdrawal		10,000	177,110	W/D Chris Dougherty
12/20/17		The Soco Group		3,367	173,742	Construction
12/20/17		The Ofelia R Arellano Trust DTS		18,000	155,742	Payment to investor
12/21/17	124	Melba Summers		5,000	150,742	"Prin Dist"
12/21/17	3001	Estafani nieto		2,550	148,192	Payroll
12/21/17		Casual Male XI		374	147,818	Clothing
12/21/17		George A Thompson Roberta L Thompson		60,000	87,818	Payment to investor
12/22/17		Customer Withdrawal		12,000	75,818	W/D Chris Dougherty
12/22/17		JTA Real Estate Holdings		10,000	65,818	Transfer
12/22/17		Hanover Insurance		333	65,485	Insurance
12/22/17		Georg E A Thompson Roberta L Thompson		40,000	25,485	Payment to investor

Id.

The balance in US Bank account ending in 1002 was \$8,329.10 when \$219,378.46 was received from the Taniyama Recoverable Trust on January 18, 2018. See Dennis Decl. at ¶ 40. By January 24 when the funds had been spent, the

1 balance of the account had been reduced to \$1,208.79. Id.; Exh. 4, 5 to Dennis
2 Decl.

3 From the bank documents, the UST prepared an accounting of how the
4 \$219,378.46 was spent. Id. Legible notations from copies of the investor canceled
5 checks in Exhibits 4 and 5 are designated with quotation marks:

Date	Ck #	Payee/ Description of transaction	Deposits	With/ drawals	Bank Balance	Description
1/17/18		Beginning bank balance			8,329	
1/18/18		Wire credit	219,378		227,708	Taniyama Recoverable Trust
1/18/18		WestAir Gases & Equipment		1,100	226,608	Construction
1/18/18		Internet Banking Transfer		6,000	220,608	Transfer to Dougherty Family Trust - US Bank 0756
1/18/18		Internet Banking Transfer		49,000	171,608	Transfer to Dougherty Family Trust - US Bank 0757
1/18/18		Customer Withdrawal		10,500	161,108	W/D Chris Dougherty
1/18/18		Deposit item returned		15,755	145,353	Return check # 992 from C&D BofA account #3774
1/18/18		Customer Withdrawal		13,000	132,353	W/D Chris Dougherty
1/19/18		The Ofelia R Arellano Trust DTS		10,000	122,353	Payment to investor
1/19/18		Carol Pouliot Poway CA		20,000	102,353	Payment to investor
1/19/18	3005	Jerry and Anita Cole		6,502	95,850	"CN0026"
1/19/18		Fedex		22	95,829	Office expense
1/19/18		Internet Banking Transfer		2,000	93,829	Dougherty Family Trust - US Bank 0756
1/19/18		Mobile Banking Transfer		12,000	81,829	Dougherty Family Trust - US Bank 0756

1	1/19/18		Deposited item returned		18,975	62,854	Return check # 993 from C&D BofA account #3774
2	1/22/18		Customer deposit	1,000		63,854	Whitney R Hulsey
3	1/22/18		Family Auto Serv Alpine CA		1,235	62,618	Auto expense
4	1/22/18		Andrew Myers		1,790	60,828	Legal
5	1/22/18		Buildin		2,000	58,828	Other
6	1/22/18		Internet banking transfer		4,000	54,828	Nereida & Christopher Dougherty - US Bank 0822
7	1/22/18		Customer Withdrawal		7,000	47,828	W/D Chris Dougherty
8	1/22/18		Customer Withdrawal		8,000	39,828	W/D Chris Dougherty
9	1/23/18	3004	Robin Kavamaugh		1,840	37,988	Payment to investor
10	1/23/18	3007	Cardmember Service		1,500	36,488	Credit card payment
11	1/23/18		Customer Withdrawal		15,800	20,688	W/D Chris Dougherty
12	1/23/18	3006	Jose Munoz		1,800	18,888	Office expense
13	1/23/18	3008	Cardmember Service		7,500	11,388	Credit card payment
14	1/24/18		The Ofelia R Arellano Trust DTS		10,000	1,388	Payment to investor
15	1/24/18		Siggys 2		39	1,349	Meals
16	1/24/18		Dmi Dell Sm Bus		141	1,209	Office expense

12 Id.

13 The balance in US Bank account ending in 1002 was \$1,208.79 when
14 \$125,000 was received from the Spruill Family Trust on January 25, 2018. See
15 Dennis Decl. at ¶ 41. By January 31 when most of the funds had been spent, the
16 balance of the account had been reduced to \$11,555.05. Id.; Exh. 4, 5 to Dennis
17 Decl.

18 From the bank documents, the UST prepared an accounting of how the
19 \$125,000 was spent. Legible notations from copies of the investor canceled
20 checks in Exhibits 4 and 5 are designated with quotation marks:

Date	Ck #	Paid to/Received from	Deposits	With/withdrawals	Bank Balance	Description
1/25/18		Beginning balance			1,209	
1/25/18		Wire credit	125,000		126,209	Spruill Family Trust
1/25/18		Internet Banking Transfer		2,500	123,709	Nereida & Christopher Dougherty - US Bank 0822
1/25/18		Internet Banking Transfer		15,000	108,709	C & N Dougherty - US Bank 0756
1/25/18		Non-Sufficient Funds Fee		36	108,673	Bank Fees
1/26/18		DMI DELL SM BUS		2,928	105,744	Office expense
1/26/18		Customer Withdrawal		22,000	83,744	W/D Chris Dougherty
1/26/18	3011	Cana Technology		1,245	82,499	Office expense
1/29/18		Office Furniture		344	82,155	OFFICE FURNITURE
1/29/18		Toms Hay Farm		4,800	77,355	Farm expense
1/29/18		Customer Withdrawal		5,900	71,455	W/D Chris Dougherty
1/29/18		Customer Withdrawal		10,000	61,455	W/D Chris Dougherty
1/29/18	3012	JTA Real Estate Holdings LLC		7,500	53,955	JTA Real Estate - California Bank & Trust 8975
1/29/18		Customer Withdrawal		4,000	49,955	W/D Chris Dougherty
1/30/18	3014	Martha Pittson		950	49,005	"CN0008 4 th QTR 2017"
1/30/18	3010	Elena Totten		15,450	33,555	Payment to investor
1/30/18		Family Auto Service		2,020	31,535	Auto
1/30/18		Customer Withdrawal		10,500	21,035	W/D Chris Dougherty
1/31/18	3018	Alan & Aleica Silver		6,431	14,604	"CN0023 4 th QTR"
1/31/18	3013	Jeffrey & Patricia Kiser		3,000	11,604	"CN0004 4 th QTR 2017"
1/31/18		Intuit Payroll		49	11,555	Office

17
18 Id.

19 The balance in US Bank account 1002 was \$7,471.77 when \$125,000 was
20 received from the Spruill Family Trust on February 2, 2018. See Dennis Decl. at ¶
21

1 42. By February 13 when most of the funds had been spent, the balance of the
2 account had been reduced to \$11,203.09. Id.; Exh. 6, 7 to Dennis Decl.

3 From the bank documents, the UST prepared an accounting of how the
4 \$125,000 was spent. Legible notations from copies of the investor canceled
5 checks in Exhibit 6 and 7 are designated with quotation marks:

Date	Ck #	Paid to/Received from	Deposits	With/withdrawals	Bank Balance	Description
2/2/18		Beginning balance			7,472	
2/2/18		Wire In	125,000		132,472	Spruill Family Trust
2/2/18		Mobile banking transfer	3,000		135,472	Nereida & Christopher Dougherty - US Bank 0822
2/2/18		DONALD J BIAGI		5,671	129,801	Payment to investor
2/2/18		CAROL POULIOT		30,000	99,801	Payment to investor
2/2/18	3016	City Treasurer		63	99,738	Tax
2/2/18		Customer Withdrawal		5,500	94,238	W/D Chris Dougherty
2/2/18	3015	Bryan Dougherty		4,059	90,179	Dougherty Family member
2/2/18		Customer Withdrawal		10,000	80,179	W/D Chris Dougherty
2/2/18		EGNYTE INC		45	80,134	Office expense
2/2/18		AMAZON.COM		1,700	78,434	Amazon
2/2/18		Internet banking transfer		3,000	75,434	Nereida & Christopher Dougherty - US Bank 0822
2/5/18	3022	Melba Summers		1,410	74,024	"CN0017 4 th QTR"
2/5/18		Wire Out		1,488	72,537	Payment to investor
2/5/18		Customer Withdrawal		3,000	69,537	W/D Chris Dougherty

1	2/5/18	3026	JTA Farm - CBT 8983		6,000	63,537	To Dougherty controlled company
2	2/5/18		INTUIT QB ONLIN		15	63,522	Office expense
3	2/5/18		INTUIT QB ONLIN		15	63,507	Office expense
4	2/5/18		INTUIT QB ONLIN		15	63,492	Office expense
5	2/5/18		CARL S JR 110062		16	63,476	Meals
6	2/5/18		ALPINE SUSHI		55	63,421	Meals
7	2/5/18		DESTINATION XL		493	62,928	Clothing
8	2/6/18	3027	JTA Farm		4,000	58,928	To Dougherty controlled company
9	2/6/18	3031	Christopher Dougherty		2,000	56,928	W/D Chris Dougherty
10	2/6/18	3032	RD3 Inc.		2,000	54,928	To Dougherty controlled company
11	2/6/18		AZTEC APPLIANCE		30	54,898	Appliance or personal expense
12	2/6/18		GLOBAL R USA		495	54,403	Other
13	2/6/18		AZTEC APPLIANCE		650	53,753	Appliance or personal expense
14	2/6/18		MERCEDES BENZ OF		1,999	51,754	Auto
15	2/7/18		Reversal	31		51,785	Bank Correction
16	2/7/18		Deposit	393		52,177	Cheryl & Donald Biagi
17	2/7/18		Proof correction debit		31	52,147	Bank Correction
18	2/7/18	3028	Copysport		1,664	50,483	Copier
19	2/7/18		EGNYTE INC		95	50,388	Office expense
20	2/8/18		Reversal	31		50,419	Bank Correction
21	2/8/18	3024	Jeffrey & Patricia Kiser		2,050	48,369	"CN0007 4 th QTR"
22	2/8/18	3023	Jeffrey & Patricia Kiser		2,050	46,319	"CN0007 3 rd QTR"
23	2/8/18	3033	Jose Munoz		1,783	44,536	Maintenance
24	2/8/18		The Home Depot		4	44,532	Repairs
25	2/8/18		The Home Depot		246	44,286	Repairs
26	2/9/18		Customer Withdrawal		3,000	41,286	W/D Chris Dougherty
27	2/9/18		DONATO S ITALIAN		35	41,251	Meals
28	2/9/18		Mobile Banking Transfer		3,000	38,251	Transfer to Nereida & Christopher Dougherty - US Bank 0822
29	2/12/18		Deposit	12,000		50,251	Christopher Dougherty

1	2/12/18	996	Deposit	2,500		52,751	C&D Prof Svcs - BofA 3774
2	2/12/18	3030	Melvin & Helen Rader		2,150	50,601	Payment to investor
3	2/12/18		Customer Withdrawal		7,000	43,601	W/D Chris Dougherty
4	2/12/18	3034	JTA Farm		15,000	28,601	To Dougherty controlled company
5	2/12/18	3037	James Lara		910	27,690	Computer exp
6	2/12/18	3035	JTA Real Estate		4,000	23,690	To Dougherty controlled company
7	2/12/18		INTUIT QB ONLIN		15	23,675	Office expense
8	2/12/18		POSTALANNEX 201		55	23,620	Office expense
9	2/12/18		JANET S MONTANA		187	23,433	Meals
10	2/12/18		MICROSOFT STO		230	23,203	Office expense
11	2/13/18		Deposit	11,000		34,203	C&D Prof Svcs - BofA 3774
12	2/13/18		Branch Telephone Transfer	1,500		35,703	Transfer from Acct 0822
13	2/13/18		Branch Telephone Transfer	1,500		37,203	Transfer from Nereida & Christopher Dougherty - US Bank 0822
14	2/13/18		CAROL POULIOT		11,000	26,203	Payment to investor
15	2/13/18	3040	JTA Real Estate		15,000	11,203	Rent

14
15 Id.

16 In March 2018, C&D received two investments totaling \$140,000 from the
17 Spruill Family Trust. The balance in Bank of America account ending in 3774 was
18 \$857.45 when \$120,000 was received from the Spruill Family Trust on March 15,
19 2018. See Dennis Decl. at ¶ 43. By March 21, the balance of the account had been
20 reduced to \$43,220.86. Id. On March 22, a \$20,000.00 wire transfer from Harriet
21

1 Mann Taniyama was received. By March 30, the balance of the account had been
2 reduced to \$5,455.92. Id.; Exh. 8 to Dennis Decl.

3 From the bank documents, the UST prepared an accounting of how the
4 \$140,000 was spent. Id. Legible notations from copies of the investor canceled
5 checks in Exhibit 8 are designated with quotation marks:

Date	Ck #	Paid to/Received from	Deposits	With/withdrawals	Bank Balance	Description
3/15/18		Beginning balance			857	
3/15/18		Wire credit	120,000		120,857	Alan Silver
3/16/18		Bank Fees		15	120,842	Bank fees
3/16/18		Wire out		12,000	108,842	JTA Real Estate
3/16/18		Bank Fees		30	108,812	Bank fees
3/16/18	4005	Cardmember Services		9,000	99,812	Credit card payment
3/16/18	4004	James Lara		900	98,912	Office
3/16/18		Customer withdrawal		3,750	95,162	W/D Chris Dougherty
3/19/18		Auto Radio Specialists		199	94,963	Auto
3/19/18		Amazon Mktplace PMTS		8	94,956	Amazon
3/19/18		Wild Bills Wst		615	94,341	Clothing
3/19/18		Vintana Restaurant		172	94,169	Meals
3/19/18		INTUIT *QB ONLINE		15	94,154	Office
3/19/18		The Gambling Cowboy		31	94,123	Meals
3/19/18		Filippi's Pizza Grotto		55	94,068	Meals
3/19/18		Amazon Mktplace Pmts WW		395	93,674	Amazon
3/19/18		The Bank Of Mexican Foo		216	93,458	Meals
3/19/18		ATM Withdrawal		503	92,955	W/D Chris Dougherty
3/19/18		Bank Fees		3	92,952	Bank fees
3/19/18	4002	Deborah Gerlack		200	92,752	Bank fees
3/20/18		Cash withdrawal		6,000	86,752	W/D Chris Dougherty
3/20/18		Customer withdrawal		10,000	76,752	W/D Chris Dougherty
3/21/18		TLR transfer to CHK 0222		27,000	49,752	Transfer toBofA Acct 0222
3/21/18	4003	Helena Dougherty		6,500	43,252	Payment to Dougherty family member
3/21/18		Fedex		31	43,221	Office

1	3/21/18		Albertsons Sto		59	43,162	Food
2	3/22/18		Wire in	20,000		3,162	Harriet Mann Taniyama
3	3/22/18	4007	Jeffrey & Harriet Taniyama		800	62,362	Payment to investor
4	3/22/18	4008	Christopher Dougherty		2,500	59,862	W/D Chris Dougherty
5	3/23/18		Bank Fees		15	59,847	Bank fees
6	3/23/18		cash withdrawal		10,000	49,847	W/D Chris Dougherty
7	3/23/18		Customer withdrawal		1,295	48,552	W/D Chris Dougherty
8	3/26/18		cash withdrawal		1,000	47,552	W/D Chris Dougherty
9	3/26/18	4001	Steve Shafer		600	46,952	"CN0018 4 th QTR Dividend"
10	3/26/18	4006	George & Roberta Thompson		1,100	45,852	Payment to investor
11	3/26/18		TLR transfer to CHK 3868		2,000	43,852	RD3 Inc. - BofA 3868
12	3/28/18		TLR transfer to CHK 3869		1,000	42,852	RD3 Inc. - BofA 3868
13	3/28/18		cash withdrawal		2,000	40,852	W/D Chris Dougherty
14	3/28/18		TLR transfer to Chk 0222		5,000	35,852	Transfer to BofA Acct 0222
15	3/28/18		Wire out		5,000	30,852	JTA Farm Enterprises
16	3/28/18		Bank Fees		30	30,822	Bank fees
17	3/28/18	4009	Sixta Y Loyo		220	30,602	"4 th Qtr CN0029"
18	3/28/18	4010	CRS - CA REG SERVICES INC		916	29,686	Office
19	3/29/18		TLR transfer to CHK 0222		21,500	8,186	Transfer to BofA Acct 0222
20	3/29/18		Jacko Law Group Pc		1,602	6,584	Legal
21	3/29/18		Fedex		90	6,494	Office
22	3/30/18		Fedex		38	6,456	Office
23	3/30/18		ON THE BORDER		100	6,356	Meals
24	3/30/18	4011	James Lara		900	5,456	Office

Id.

The Debtors provided the UST with a copy of a letter to Alan and Aleica Silver on JTS Cattle & Hay Broker Services letterhead dated April 20, 2017. See Dennis Decl. at ¶ 44. The letter thanks the Silvers for becoming an investor and confirms that \$120,000 was invested on March 15, 2018 into a hay brokerage deal

1 paying a dividend of 10%. Id.; Exh 9 to Dennis Decl. As noted above, the Bank of
2 America statement for account ending in 3774 for March 2018 contained no
3 evidence that the \$120,000 received from the Silvers was invested in a hay
4 brokerage deal, which is completely contrary to the representation made to the
5 Silvers in the April 20, 2017 letter. Id.

6 The balance in Bank of America accounting ending in 3774 was an overdraft
7 of <\$1,481.90> when \$50,000 was received from the Spruill Family Trust on May
8 2, 2018. Dennis Decl. at ¶ 45. By May 11 when the funds had been spent, the
9 balance of the account had been reduced to a further overdraft balance of
10 <\$6,218.65>. Id.; Exh. 10, 11 to Dennis Decl.

11 From the bank documents, the UST prepared an accounting of how the
12 \$50,000 was spent. Id. Legible notations from copies of the investor canceled
13 checks in Exhibits 10 and 11 are designated with quotation marks:

Date	Ck #	Paid to/Received from	Deposits	With/withdrawals	Bank Balance	Description
5/2/18		Beginning balance			(1,482)	
5/2/18		Wire in	50,000		48,518	Spruill Family Trust
5/2/18		Return item		4,500	44,018	Charge for amount originally deposited 4/27/18
5/2/18		Bank Fees		12	44,006	Bank fees
5/2/18	4030	Returned of posted check/Item received on 5-1	200		44,206	Bank adjustment for C&D NSF check posted 5/1/18
5/2/18	4032	Elena Totten		1,650	42,556	Payment to investor
5/2/18		Customer Withdrawal Image		5,210	37,346	W/D Chris Dougherty

1	5/2/18		Customer Withdrawal Image		4,800	32,546	W/D Chris Dougherty
2	5/2/18	4036	Sixta Y Loyo		200	32,346	Payment to investor
3	5/2/18	4039	Mary Gilbert		450	31,896	Payment to investor
4	5/2/18		DESTINATION XL		459	31,438	Travel
5	5/3/18		Bank Fees		15	31,423	Bank fees
6	5/4/18		PAYCYCLE INC		1	31,422	Office
7	5/4/18		EGNYTE INC		140	31,282	Office
8	5/7/18		HOMESTEAD BAR & GRILL		57	31,225	Meals
9	5/7/18		INTUIT *QB ONLINE		17	31,208	Office
10	5/7/18		INTUIT *QB ONLINE		15	31,193	Office
11	5/7/18		Chevron		100	31,093	Auto
12	5/7/18		Chevron		78	31,015	Auto
13	5/7/18	4014	The Spa & Patio Store		5,577	25,438	Christopher Dougherty
14	5/7/18		Customer Withdrawal Image		5,010	20,428	W/D Chris Dougherty
15	5/8/18		AMAZON MKTPLACE PMTS		8	20,421	Amazon
16	5/8/18	4045	Melba Summers		5,000	15,421	"Principal Withdrawl"
17	5/9/18		BJS RESTAURANTS 497		52	15,369	Meals
18	5/9/18		AMAZON MKTPLACE PMTS WW		395	14,974	Amazon
19	5/9/18	4048	James Lara		1,050	13,924	Office
20	5/10/18		INTUIT *QB ONLINE		15	13,909	Office
21	5/10/18		CHEVRON/CSI		85	13,824	Auto
22	5/10/18	4046	Melba Summers		5,000	8,824	"Principal Withdrawl"
23	5/11/18		REDTAIL TECHNOLOGY		75	8,749	Office
24	5/11/18		CHEVRON/CSI		85	8,664	Auto
25	5/11/18		Counter Credit	2,000		10,664	Counter credit/deposit
26	5/11/18		PAYCYCLE INC	1		10,665	Other
27	5/11/18	4047	Brian & Sharon Taylor		3,053	7,611	"CN0003 1 st QTR Dividend"
28	5/11/18	4033	Jerry & Anita Cole		6,502	1,109	"CN0033 1 st QTR Dividend"
29	5/11/18	4043	CHECK #4043		7,327	(6,219)	This debtors check was returned NSF on 5/14/18

1 Id.

2 From the UST's review of available bank statements, the UST has found that
3 the \$1,159,378.46 received by the Debtors from investors during the time period
4 December 8, 2017 through May 2, 2018 were used for several purposes, none of
5 which constituted investment of the funds for the benefit of those investors. See
6 Dennis Decl. at ¶ 46.

7 The Debtors' practice of using new investment money to pay existing
8 investors dividends and principal gave the false impression that the payments
9 received by investors came from earnings and profits or from a return of their
10 principal. This deception is the basis of a Ponzi scheme. See Dennis Decl. at ¶ 47.

11 **MEMORANDUM OF POINTS AND AUTHORITIES**

12 **I. Cause Exists To Convert This Case To One Under Chapter 7**

13 Section 1112(b)(1) provides that a chapter 11 case may be dismissed or
14 converted to chapter 7, whichever is in the best interests of creditors, if the movant
15 establishes "cause." 11 U.S.C. § 1112(b)(1). The Bankruptcy Code contains
16 several examples of what constitutes "cause", including gross mismanagement and
17 substantial or continuing loss to or diminution of the estate and the absence of a
18 reasonable likelihood of rehabilitation. 11 U.S.C. §§1112(b)(4)(A),
19 1112(b)(4)(B).

1 The Court may find that “cause” exists to dismiss or convert this case to one
2 under chapter 7 by finding that one or more of the enumerated factors defined in
3 Section 1112(b)(4) is or are present. Or, the Court may find that “cause” exists for
4 any reason cognizable to the equitable powers of the Court. In re Hampton Hotel
5 Investors, L.P., 270 B.R. 346, 358 (Bankr. S.D.N.Y. 2001); see also Loop Corp. V.
6 U.S. Trustee, 379 F3d. 511, 515, n2 (8th Cir. 2004)(enumerated list found in
7 Section 1112(b)(4) is not an exclusive one, and the Court is not limited to those
8 specifically enumerated examples to find that “cause” exists to dismiss or convert a
9 case to chapter 7). Cause exists to dismiss or convert the instant case to one under
10 chapter 7 as follows:

11 **A. Unexcused Failure to Satisfy Timely Any Filing Or Reporting
12 Requirement And Failure To Timely Provide Information Reasonably
13 Requested By The UST**

14 Pursuant to section 1112(b)(4)(F) of the Bankruptcy Code, cause to dismiss
15 or convert a case is present when a debtor fails to satisfy timely any filing or
16 reporting requirement established by this title or by any rule applicable to a case
17 under this chapter. See 11 U.S.C. § 1112(b)(4)(F). Pursuant to Sections 1107(a),
18 1106(a)(1), and 704(8) of the Bankruptcy Code, the Debtors are required to file
19 with the Court and the UST periodic reports and summaries of their operations,
20 including a statement of receipts and disbursements. See 11 U.S.C. § 1106(a)(1).

1 In addition, pursuant to Section 1112(b)(4)(H) of the Bankruptcy Code, a
2 debtor's failure to timely provide information reasonably requested by the UST
3 constitutes cause to dismiss or convert a bankruptcy case. See 11 U.S.C. §
4 1112(b)(4)(H).

5 In this case, the Debtors have failed to timely file monthly operating reports
6 since the case inception and have failed to timely provide information reasonably
7 requested by the UST. The Debtors filed their case on October 9, 2018, but failed
8 to file their October 2018 and November 2018 reports until January 16, 2019. See
9 Dennis Decl. at ¶ 3. Similarly, their December 2018 report was filed late on
10 February 5, 2019. The substantial delays in filing the early reports hampered the
11 ability of the UST and creditors to monitor the Debtors' spending and to bring
12 irregularities to the Court's attention. Despite having told the Debtors during the
13 341 meetings to close their pre-petition accounts, the UST did not discover until
14 review of the late-filed monthly operating reports that the Debtors continued to use
15 their PayPal and Venmo accounts post-petition. Statements for these accounts pre-
16 petition and post-petition have not been provided.

17 In addition, the monthly operating reports are wholly inadequate. The
18 Debtors filed reports containing perfunctory and incomplete information
19 concerning their deposits and withdrawals, prompting the UST to propound 38
20 questions on the Debtors regarding their transactions. See Dennis Decl. at ¶ 2. In
21

their monthly operating reports, the Debtors failed to include copies of checks and failed to explain the nature of many transfers between their account and various undisclosed accounts, some of which appear to belong to their minor children. The Debtors' subsequent explanations for these transactions was inadequate and unsatisfactory. See Dennis Decl. at ¶ 2; Exh 12 to Dennis Declaration. It is clear that under section 1112(b)(4)(F) of the Bankruptcy Code, cause to dismiss or convert a case is present.

The Debtors have also failed to timely provide information reasonably requested by the UST. Following the initial session of the 341 meeting of creditors, on December 6, 2018, the UST began requesting documents from the Debtor, and followed up with several additional requests following additional sessions of the meeting of creditors. See Dennis Decl. at 1; Exh 1 to Dennis Decl.

Notably, the Debtors have failed to open debtor-in-possession accounts and failed to close their pre-petition accounts. Also of importance is that the UST requested bank statements for all of the Debtors' entities, and upon review of the documents, discovered that 22 bank accounts remained undisclosed. *Id.* The bank statements reviewed by the UST reveal numerous large cash withdrawals by the Debtors. The UST requested information from the Debtors about these withdrawals, which has not been forthcoming. *Id.* These are only a few examples

of the deficiencies. A complete list of all outstanding items is set forth in paragraph 1 of the Dennis Declaration.

Pursuant to Section 1112(b)(4)(H) of the Bankruptcy Code, a debtor's failure to timely provide information reasonably requested by the UST constitutes cause to dismiss or convert a bankruptcy case. See 11 U.S.C. § 1112(b)(4)(H). Without timely receipt of information concerning the Debtors' business and financial affairs, the UST can't effectively and meaningfully investigate problems and monitor the progress of the case towards rehabilitation. Here, the Debtors have not been forthcoming with requested information timely and while the UST has formulated an accurate picture of the problems with the Debtors' business and financial affairs, the full scope of the issues is likely unknown due to the Debtors' lack of compliance. The UST has established cause for conversion of the case.

B. Gross Mismanagement Of The Estate

Evidence of gross mismanagement of the Estate constitutes cause for conversion under Section 1112(b)(4)(B) of the Bankruptcy Code. The following activities and omissions by the Debtors constitute gross mismanagement of the Estate: (1) filing an improper Involuntary Petition on March 13, 2019 against JTA Real Estate; (2) spending Estate funds on unnecessary and/or discretionary items; (3) spending Estate funds on expenses for related entities; (4) failing to prepare proper and complete accountings of Estate revenues and expenses; (5) spending

1 monies in excess of insider compensation permitted by the Court; (6) filing Rule
2 2015.3 reports for the Debtors' related entities that contain inaccurate and
3 misleading information; and (7) failing to pay debt service post-petition.

4 On March 14, 2019, the UST received notice that Christopher Dougherty
5 signed and filed an involuntary petition against JTA Real Estate, case number 19-
6 01366-LT11. See Dennis Decl. at ¶ 48; Exh 13 to Dennis Decl. There were no
7 petitioning creditors included in the filing other than Christopher Dougherty.

8 Although Mr. Dougherty indicated in the petition that he is owed "compensation"
9 in the amount of \$35,000, this claim is not listed in the Debtors' Schedule B. Id.
10 Upon information and belief, the filing by Christopher Dougherty was improper
11 under the requirements for an involuntary petition pursuant to the Bankruptcy
12 Code.

13 The Debtors have obtained two Orders authorizing insider compensation.
14 The first Order was entered on November 19, 2018 (docket no. 38) and permits the
15 Debtors to spend the monthly amount of \$6,527.33. The second Order was entered
16 on February 7, 2019 (docket no. 126) and permits the Debtors to spend an
17 additional \$6,500 per month, for total monthly insider compensation of
18 \$13,027.33. The disbursements reported in the monthly operating report for
19 November 2018 were \$29,764.27. See Dennis Decl. at ¶ 9. The disbursements
20 reported in the monthly operating report for December 2018 were \$25,677.95. Id.

1 The Debtors have been unjustifiably spending in excess of the amounts authorized
2 by this Court as insider compensation.

3 A review of the Debtors' post-petition spending reveals that thousands of
4 dollars have been expended on luxury and unnecessary items, including fraternity
5 dues, monthly volleyball fees in excess of \$500, college tuition for the Debtors'
6 adult child, and expenses for a timeshare resort. See Dennis Decl. at ¶ 2; Exh 12 to
7 Dennis Decl. The Debtors have not explained why the Estate is using funds to pay
8 these items when creditors have not been paid.

9 The Debtors have also been paying for expenses for their related entities
10 from Estate funds. See Dennis Decl. at ¶ 4. These expenses include: feed for
11 cattle, rent for C&D, storage fees for trucks, and labor for work on the ranch. Id.
12 The Debtors have offered no explanation why the Estate is paying expenses for
13 their related entities. From a review of the monthly operating reports and the Rule
14 2015.3 Reports, the UST is not aware of any accounting or bookkeeping entries for
15 post-petition expenses of these entities being paid by the Estate. Clearly, the
16 Debtors are not capable of properly managing their affairs as debtors-in-
17 possession.

18 The monthly operating reports reflect numerous transfers between the
19 Debtors and accounts apparently belonging to their children. See Dennis Decl. at ¶
20 10. The reports include references that are unclear, such as "transfer from shares
21

1 Alexis M Dougherty". *Id.* A detailed list of the transfers is included in paragraph
2 10 of the Dennis Declaration. As previously discussed in this Motion, the UST has
3 requested copies of statements from all bank accounts, but has not received
4 statements for accounts belonging to their children or other family members. *Id.*

5 The Debtors have not been paying debt service post-petition. *See* Dennis
6 Decl. at ¶ 26. The January 2019 monthly operating report reflected that the
7 Debtors had not made four post-petition payments to HSBC and two post-petition
8 payments to Lyon. Stay relief motions filed by Mascot Realty Inc. and Smarter
9 Capital Investments, LLC reveal additional post-petition payments that have not
10 been made. *See* Dennis Decl. at ¶ 27. Charts outlining these post-petition
11 delinquencies are set forth in paragraphs 26 and 27 of the Dennis Declaration. The
12 Debtors' failure to pay debt service might prove fatal with respect to any
13 reorganization efforts.

14 Moreover, the Debtors' mismanagement is exacerbated when the UST
15 cannot obtain information and documents in a reasonable and efficient manner.
16 The Debtors have not managed the Estate in accordance with their obligations as
17 debtors-in-possession. Cause for conversion has been established.

18 //

19 //

20

21

C. Continuing Loss to the Estate and Absence of a Reasonable Likelihood of Rehabilitation

11 U.S.C. § 1112(b)(4)(A) allows this court to dismiss or convert a case where there is continuing loss to the estate, and the absence of a reasonable likelihood of rehabilitation. Section 1112(b)(4)(A) effectuates the purpose of Section 1112(b)(1), which is “to preserve estate assets by preventing the debtor in possession from gambling on the enterprise at the creditors' expense when there is no hope of rehabilitation.” Loop Corp. v. U.S. Trustee, 379 F.3d 511, 516 (8th Cir. 2004). Diminution need not be significant; all that is required “is that the estate has suffered some diminution in value.” In re Mense, 509 B.R. 269, 284 (Bankr. C.D. Cal. 2014) (internal citation omitted). In turn, “[r]ehabilitation contemplates the successful maintenance of the debtor's business operations.” *Id.* (internal quotation marks and citation omitted).

Thus, the “issue of rehabilitation for purposes of § 1112(b)(4)(A) is not a technical one of whether the debtor can confirm a plan, but, rather, whether the debtor’s business prospects justify continuance of the reorganization effort.” In re Hassen Imports Partnership, 2013 WL 4428508 (9th Cir BAP Aug. 19, 2013); See also In re Mense, 509 B.R. at 284 (“[a] reasonable likelihood of rehabilitation is absent when the debtor’s business operations do not justify continuance of the reorganization effort.”).

1 There is robust evidence of continuing losses to the Estate and similarly
2 strong indications that successful reorganization is unlikely and there are no
3 prospects that justify continuation of the chapter 11 case. At the session of the 341
4 meeting of creditors held on January 15, 2019, Christopher Dougherty testified that
5 JTA Real Estate would file a chapter 11 case and then file a joint plan of
6 reorganization with the Debtors. Dennis Decl. at ¶ 13. He further testified that the
7 plan would be funded by a sale of the ranch at 21702 Japatul Road in Alpine,
8 which is owned by JTA Real Estate, as well as through income generated by the
9 use of the trucks owned by JTA Real Estate. *Id.* At this time, it does not appear
10 that either avenue of funding would lead to a confirmable plan for the Debtors or
11 otherwise constitute prospects that justify the Debtors remaining in chapter 11.

JTA Real Estate did not file a Chapter 11 case, as Christopher Dougherty testified it planned to do. On March 13, 2019, Christopher Dougherty filed an involuntary petition against JTA Real Estate. The propriety of this action might have unfavorable consequences for the Debtors' Estate. With respect to the reorganization of the Debtors, however, this action by Christopher Dougherty likely does not further his efforts to achieve a sale and joint plan for the benefit of the creditors in this case. In filing the involuntary petition, Christopher Dougherty is stating that his entity, JTA Real Estate, is insolvent and can't re-pay its creditors. This does not bode well for either the Debtors or JTA Real Estate.

In addition, a review of the 2015.3 periodic reports filed by the Debtors for JTA Real Estate reveal that it does not operate profitably. As explained earlier in this Motion, the Rule 2015.3 reports filed for JTA Real Estate reflect losses for all periods except for January 2018 - November 2018, which purports to report a gain of \$96,963.35. Dennis Decl. at ¶ 17. When the UST adjusted the profit and loss statement for “Reconciliation Discrepancies”, the adjustment resulted in a loss of <\$477,830.80>. Dennis Decl. at ¶ 18.

The Rule 2015.3 reports filed by the Debtors for JTA Farms similarly reflect that it is not operating profitably and also reveal questionable accounting. When the UST made appropriate adjustments, there was a net loss in 2017 of <\$194,387.64>. Dennis Decl. at ¶ 19 – 20. The profit and loss statement included with the Rule 2015.3 report for January to December 2018 reports a loss of <\$78,498.16>. Dennis Decl. at ¶ 21.

Also, this report for JTA Farms contained unusual accounting. Dennis Decl. at ¶ 22. The general ledger included with the report reveals that \$105,000 in income consisted of “equity deposits” received from the “Dougherty Family Trust Fund”. Id. These deposits consisted of six \$15,000 monthly receipts received between February 1, 2018 and July 1, 2018. Id. The general ledger also reported \$155,097.77 in “Reconciliation Discrepancies” that are not explained in the report. Id.

1 When the UST adjusted the 2018 profit and loss statement for “equity
2 deposits” and “reconciliation discrepancies”, the adjusted net loss for this period
3 was <\$28,379>. Dennis Decl. at ¶ 23.

4 The profit and loss statement included with the 2015.3 report for January
5 2019 for JTA Farms also includes a \$15,000 equity deposit apparently received in
6 January 2019 and classified as income. Dennis Decl. at ¶ 24. The general ledger
7 included with the report did not include an account for equity contributions.
8 Therefore, the UST was unable to determine if the source of the \$15,000 was also
9 the Dougherty Family Trust Fund. Dennis Decl. at ¶ 25. The Debtors’ January
10 2019 Operating Report does not include any disclosure about this \$15,000, and
11 does not reference the Dougherty Family Trust Fund. *Id.* To date, the UST has
12 been unable to determine the source of funds associated with the Dougherty
13 Family Trust Fund.

14 In addition, the Debtors cannot reorganize using income from the trucks
15 owned by JTA Real Estate. The Debtors testified during the 341 meeting of
16 creditors that their entity, RD3, Inc., is a trucking business that purportedly
17 operates using trucks owned by JTA Real Estate. However, upon information and
18 belief, RD3 does not currently have business operations and also, has never
19 profitably operated a trucking business.

1 The Debtors filed four Rule 2015.3 periodic reports for RD3, Inc., which
2 collectively cover the time period January 2016 through January 2019. These
3 reports reflect net gains and losses that demonstrate that RD3, Inc.'s operations do
4 not have the ability to fund a plan. Dennis Decl. at ¶ 16. Furthermore, a review of
5 the associated general ledgers shows that 71.2% of the income reported income for
6 2017 and 86.6% of the income reported by RD3, Inc. for 2018 was for work
7 performed for entities controlled by the Debtors. Dennis Decl. at ¶ 15. A
8 summary of the reported income of RD3, Inc. is set forth in paragraph 15 of the
9 Dennis Declaration.

10 The Rule 2015.3 reports show that RD3, Inc. does not have revenues from
11 third party customers that could fund a chapter 11 plan. Dennis Decl. at ¶ 16.
12 There is no basis to conclude that the Debtors have experience operating a
13 business, using the trucks owned by JTA Real Estate, with revenues sufficient to
14 fund a chapter 11 plan. Id.

15 Also impacting any reorganization efforts is that the operating reports and
16 the motions for relief from the automatic stay filed in this case report that the
17 Debtors are delinquent on the pre and post-petition mortgage obligations. Dennis
18 Decl. at ¶ 26. The January 2019 Operating Report reports post-petition
19 delinquencies to HSBC and Lyon/Chestnut. Id. Moreover, the Court docket for

1 this case reveals that 12 adversary complaints predicated on section 523 to
2 determine dischargeability of debt have been filed against the Debtors.

3 The entities owned by the Debtors have demonstrated pre-petition and post-
4 petition that they do not have the ability to generate net income that can be used to
5 fund a plan. See Dennis Decl. at ¶ 29. RD3, Inc. is not operating and neither JTA
6 Farms nor JTA Real Estate is able to produce net income. Id. The Debtors and
7 their entities have been unable to timely pay their monthly post-petition mortgage
8 payments and appear to have no ability to fund the defense of the 12 adversary
9 proceedings. Indeed, it was reported by Debtors' counsel on the record during the
10 hearing on February 28, 2019 that the Debtors had instructed him not to oppose
11 any adversary proceeding and to stipulate to the full amount being requested in
12 each adversary complaint. The liability of the Estate attributable to these adversary
13 proceedings is currently unknown.

14 The losses to the Estate are substantial and continuing, and the Debtors are
15 unlikely to be able to successfully reorganize. The Debtors have not demonstrated
16 any business prospects that justify continuing this chapter 11 case. Cause for
17 conversion has been established.

18 **D. Conversion to Chapter 7 is in the Best Interests of the Estate**

19 There are many unanswered questions in this case, and it should be closely
20 examined by a trustee. A pressing question concerns the final disposition of the
21

1 proceeds received from investors. As set forth earlier in this Motion, it appears
2 that over \$1.1 million received from investors in 2018 was not invested, a portion
3 of which might be in the possession of the Debtors in the form of cash. A trustee
4 should consider the possibility of undisclosed accounts and assets, including the
5 accounts apparently belonging to the Debtors' children.

6 In addition, a trustee is in the best position to determine the appropriate
7 course of action with respect to the Debtors' interest in their closely-held entities.
8 A trustee should step into their shoes to manage and direct those interests in the
9 best interests of creditors. It's clear that an independent party should examine the
10 case and make a recommendation for the final disposition of the case.

11 **II. In The Alternative, A Chapter 11 Trustee Should Be Appointed**

12 The UST is aware that the Debtors collect rents from real property owned by
13 the Debtors and that they own substantial percentages of four closely-held
14 businesses. Although it is not immediately clear to the UST that the Debtors have
15 active business operations that warrant the appointment of a chapter 11 trustee, the
16 UST has been misled by the Debtors in this case, and does not trust their
17 representation of the status of the operations. In addition, the UST wishes to
18 consider and preserve the possibility that a chapter 11 trustee might be needed due
19 to the difficulties in administering the complexities of the case and the business
20 interests.

1 Section 1104(a) of the Bankruptcy Code provides:

2 At any time after the commencement of the case but before confirmation of
3 a plan... the court shall order the appointment of a trustee-

4 (1) for cause, including fraud, dishonesty, incompetence, or gross
5 mismanagement of the affairs of the debtor by current management, either
6 before or after the commencement of the case...

7 (2) if such appointment is in the interest of creditors, any equity
8 security holders, and other interests of the estate...

9
10 11 U.S.C. § 1104(a).

11 In this case, the Debtors have been managing the affairs of the bankruptcy
12 estate as Debtors-in-Possession since the commencement of the chapter 11 case.

13 The Debtor-in-Possession is a fiduciary for the estate and its creditors. See In re
14 Count Liberty, LLC, 370 B.R. 259, 275-76 (Bankr.C.D.Cal. 2007), citing
15 Thompson v. Margen (In re McConville), 110 F.3d 47, 50 (9th Cir. 1997);
16 Woodson v. Fireman's Fund Ins. Co. (In re Woodson), 839 F.2d 610, 614 (9th Cir.
17 1988); and Devers v. Bank of Sheridan Montana (In re Devers), 759 F.2d 751, 754
18 (9th Cir. 1985).

19 In this case, "cause" for appointment of a chapter 11 trustee exists under
20 section 1104(a)(1) of the Bankruptcy Code due to pre-petition fraud and post-
21 petition gross mismanagement. The Debtors' post-petition gross mismanagement
has been outlined earlier in this Motion with respect to the UST's argument that

1 cause to convert the case has been established pursuant to Section 1112(b)(4)(B) of
2 the Bankruptcy Code.

3 As also noted earlier in this Motion, the UST has found substantial and
4 credible evidence that, pre-petition, the Debtors engaged in a Ponzi scheme with
5 respect to funds received from investors. From the UST's review of available bank
6 statements, the UST has found that the \$1,159,378.46 received by the Debtors
7 from investors during the time period December 8, 2017 through May 2, 2018
8 were used for several purposes, none of which constituted investment of the funds
9 for the benefit of those investors. See Dennis Decl. at ¶ 46.

10 The Debtors' practice of using new investment money to pay existing
11 investors dividends and principal gave the false impression that the payments
12 received by investors came from earnings and profits or from a return of their
13 principal. This deception is the basis of a Ponzi scheme. See Dennis Decl. at ¶ 47.
14 This Ponzi scheme is clearly fraud that constitutes "cause" within the meaning of
15 Section 1104(a) of the Bankruptcy Code.

16 In addition, Section 1104(a)(2) creates a flexible standard for appointing a
17 trustee when it is in "the interests of creditors, equity security holders and other
18 interests of the estate." In re: SonicBlue Inc., 2007 Bankr, LEXIS 1057 *30
19 (Bankr. N.D. Cal. 2007), quoting, In re Sharon Steel Corp., 871 F.2d 1217, 1226
20 (3d Cir. 1989). The Debtors are currently subject to 12 adversary proceedings filed
21

1 by creditors under Section 523 requesting that debts be declared non-
2 dischargeable. Conflict between a debtor and its creditors can constitute cause for
3 appointment of a Chapter 11 Trustee. In re Marvel Entertainment Group, Inc.,
4 140 F.3d 463, 472-73 (3rd Cir. 1998).

5 In addition, as the facts continue to unfold, the UST would like to preserve
6 the opportunity to request that the Court consider appointment of a chapter 11
7 trustee if it becomes known prior to the hearing on this Motion that either the
8 Debtors' business operations are such that a chapter 11 trustee is needed for
9 ongoing business operations or the Debtors' business interests and financial affairs
10 are too complex to be appropriately handled within the context of a chapter 7 case.

11 **CONCLUSION**

12 These Debtors cannot remain in possession due to their mismanagement of
13 the Estate, their inability to successfully reorganize, their failure to timely comply
14 with reporting requirements and UST requests for information, and their pre-
15 petition fraudulent conduct with investor funds. A trustee must be appointed for
16 cause and in the best interest of creditors. The UST would like to further consider,
17 and asks that the Court and creditors further consider, whether a chapter 7 trustee
18 //

19 //

20

21

1 or a chapter 11 trustee would best serve the interests of the Estate and creditors in
2 this case.

3 Respectfully submitted,

4
5 TIFFANY L. CARROLL
ACTING UNITED STATES TRUSTEE

6 Dated: March 14, 2019

7 By: /s/ Kristin T. Mihelic
Kristin T. Mihelic
8 Attorney for the Acting United
States Trustee

9
10
11
12
13
14
15
16
17
18
19
20
21